

National-Local Strategy (in which the merged firm will enter 30 out-of-region cities as a competitive LEC), which they assert, in turn, will spark local exchange competition around the country and in certain foreign markets. Second, the Applicants claim that the merger will generate efficiencies in the forms of procurement savings, consolidation efficiencies, implementation of best practices, faster and broader roll-out of new products and services, and benefits to employees and communities. Third, they maintain that the merger will produce public interest benefits in other product markets, including wireless services, Internet services, long distance and international services and global seamless services for large business customers.<sup>483</sup> We discuss each of these in turn, and conclude that the Applicants have provided insufficient evidence to support any of their claims and that they have not demonstrated that, on balance, the merger is in the public interest, convenience and necessity.

### A. National-Local Strategy

259. *Background.*<sup>484</sup> According to the Applicants, the National-Local Strategy is “the essentially simultaneous, facilities-based entry of the combined company into each of the Top 30 major U.S. markets outside of the area in which the combined company would be the incumbent carrier.”<sup>485</sup> As originally formulated, the Strategy commits the merged entity to entering these 30 out-of-region metropolitan markets within three years following consummation of the merger.<sup>486</sup> Additionally, it calls for extending the Applicants’ facilities-based geographic reach to 14 major foreign markets within five years of the close of the proposed merger.<sup>487</sup>

<sup>483</sup> SBC/Ameritech July 24 Application at 92-102.

<sup>484</sup> We discuss and evaluate here the proposal set forth in the Applicants’ initial application. The Applicants have incorporated the National-Local Strategy, modified from the initial application, as a proposed condition to our approval of the merger. See Section VII.B.3. (Fostering Out-of-Territory Competition).

<sup>485</sup> SBC/Ameritech July 24 Application at 5.

<sup>486</sup> Narrative Response of SBC Communications Inc. to the FCC’s Jan. 5, 1999 Request for Supplemental Information, Feb. 2, 1999 at 12-13. (SBC Feb. 2 Narrative Response) These markets include (ranked by size): New York, Philadelphia, Boston, Washington, Miami-Ft. Lauderdale, Atlanta, Minneapolis-St. Paul, Phoenix, Baltimore, Seattle-Everett, Denver - Boulder, Pittsburgh, Tampa - St. Petersburg, Portland, Cincinnati, Salt Lake City - Ogden, Orlando, Buffalo, New Orleans, Nashville - Davidson, Memphis, Las Vegas, Norfolk - Virginia Beach, Rochester, Greensboro - Winston-Salem, Louisville, Birmingham, Honolulu, Providence-Warwick, Albany-Schenectady-Troy. SBC/Ameritech July 24 Application at 12, Kahan Aff. at para. 34, and Attach. A, *New Markets for the New SBC*. Domestically, the Applicants initially plan to roll out voice and data services to large and medium-sized businesses in three markets, Boston, Miami and Seattle, in the second quarter of the year 2000. The Applicants then plan to enter 12 more markets in early 2001, within 18 months following the consummation of the merger, and the remaining 15 markets before the end of the third year following consummation of the merger. SBC Feb. 2 Narrative Response at 13-14. The Applicants also commit that, within 24 months of entering each new market, they will begin offering facilities-based services to all residential and business customers. SBC/Ameritech July 24 Application, Kahan Aff. at para. 63. On April 16, 1999, SBC filed applications with the utility commissions of Florida, Massachusetts and Washington and said it plans to be a facilities-based provider in each market, and plans to begin offering service in each of these markets within 12 months after the merger closes. See SBC Press Release, *SBC Files to Provide Local Exchange Services in Florida, Massachusetts and Washington* (April 16, 1999). On May 13, 1999, SBC added three new cities - New York, Washington DC, and Phoenix - to the list of initial markets the company will enter following the completion of the merger. See SBC Press Release, *SBC Adds New York, Washington, Phoenix to List of First New Markets Following Merger* (May 13, 1999).

<sup>487</sup> SBC/Ameritech July 24 Application at 17, Kahan Aff. at para. 67.

260. The Applicants maintain that the National-Local Strategy contemplates a “smart build” strategy in constructing facilities that are most needed and combining them with leased transport where available and with UNEs where necessary.<sup>488</sup> More specifically, the Applicants plan to install initially over 60 switches for the large and mid-size business segment in the 30 new markets. Subsequently, they plan to install over 80 additional switches for the small business and residential customer segment,<sup>489</sup> and to construct an intra-city fiber network of between 75 and 125 fiber miles in each of the 30 targeted markets,<sup>490</sup> (along with leasing inter-city trunks from third parties.)<sup>491</sup> Applicants acknowledge that the architecture of the network and the facilities used will vary from market to market, and that they will build facilities, buy capacity, partner with another competitive LEC, and/or use some combination of these approaches.<sup>492</sup> Although it is not clear from the record whether the Applicants will buy or lease switches, nor whether they will lease or construct their own fiber, it does appear that they intend to construct some facilities.

261. In international markets, the Applicants plan to target large multinational customers in certain European, South American and Asian markets.<sup>493</sup> In these markets, Applicants contemplate initially installing one switch per city by 2001, and subsequently installing an additional 13 switches for a total of 27 by the end of their business plan.<sup>494</sup> According to the Applicants, they plan to lay fiber in these cities, with 1,400 kilometers of fiber installed within two years of the merger’s close and more than 2,000 kilometers installed by the end of the plan.<sup>495</sup>

262. Many large firms headquartered in current Ameritech or SBC territory have additional business locations out of Ameritech’s and SBC’s regions. The Applicants’ rationale behind the National-Local Strategy is to follow large and mid-size in-region multi-location business customers of the combined firm out-of-region into markets around the country and globe where those businesses have satellite offices or plant facilities.<sup>496</sup> The Applicants’ strategy appears to be to offer these customers a full range of local, vertical, long distance, data and other services.<sup>497</sup> In this fashion, the Applicants hope to become an end-to-end provider of a full range of telecommunications services to large business customers with multiple locations. These customers would function as “anchor tenants,” justifying the Applicants’ entry into markets and

<sup>488</sup> SBC/Ameritech July 24 Application at 15, Kahan Aff. at para. 39.

<sup>489</sup> SBC/Ameritech July 24 Application at 15, Kahan Aff. at para. 37.

<sup>490</sup> SBC/Ameritech July 24 Application at 5, Kahan Aff. at para. 38. This amounts to 2,900 fiber miles overall.

<sup>491</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 39.

<sup>492</sup> *Id.* at para. 55.

<sup>493</sup> *Id.* at para. 67. The actual foreign cities appear to be in question. The Applicants do say that their plans include “European markets such as Berlin, Hamburg, Frankfurt, and London; South American markets such as Rio de Janeiro and Sao Paulo; and Asian markets including Tokyo, Hong Kong and Singapore.”

<sup>494</sup> *Id.* at para. 67. The National Local Strategy is based on a 10-year plan, from 1999 to 2008.

<sup>495</sup> *Id.*

<sup>496</sup> SBC/Ameritech July 24 Application at 5.

<sup>497</sup> The Applicants are currently unable to provide this complete range of services to customers in-region.

facilitating the eventual deployment of voice and data services to small businesses and residential customers within those markets.<sup>498</sup>

263. *Rationale for the Merger.* SBC claims that the merger with Ameritech, standing alone, “is certainly not a compelling business opportunity for SBC.” Rather, SBC regards the merger as “the means” and the National-Local Strategy “as the objective.”<sup>499</sup> The Applicants further state that SBC’s Board of Directors did not approve the merger “as an end in itself,” but rather “as necessary for the company’s pursuit of its National-Local Strategy.”<sup>500</sup> According to the Applicants, the real value creation for SBC shareholders “lies entirely” in the Applicants’ successful execution of, and resulting benefits from, the National-Local Strategy.<sup>501</sup>

264. The Applicants contend that neither SBC nor Ameritech individually could pursue the National-Local Strategy as currently envisioned. In support of this claim, Applicants first submit that “[n]either SBC nor Ameritech currently has the scale, scope, resources, management and technical ability to implement the proposed national and global strategy on its own.”<sup>502</sup> The Applicants further maintain that “neither [company] alone could suffer the earnings dilution that would accompany implementation of this plan.”<sup>503</sup>

265. Thus, the Applicants assert that the merger is necessary to achieve the National-Local Strategy. Specifically, the Applicants believe that only through a merger will the combined company have: (1) the customer base (economies of scale); (2) the financial resources and reduced earnings dilution; (3) the geographic reach (economies of scope); and (4) the managerial and employee talent necessary to implement successfully the National-Local Strategy. We examine these claims more fully below.

266. *Claimed Benefits.* Applicants assert that the combined company’s implementation of the National-Local Strategy will facilitate enhanced out-of-region local exchange competition, which, in turn, will escalate in-region local exchange competition.<sup>504</sup> Specifically, the Applicants maintain that their joint entry into 30 new out-of-region markets will “jump start competition for business and residential customers throughout the country.”<sup>505</sup> The Applicants claim that a key benefit is that “[n]o other major competitive LEC currently provides service in each of the 30 markets that the new SBC plans to enter.”<sup>506</sup> This salvo of new nationwide local

<sup>498</sup> SBC/Ameritech July 24 Application at 5.

<sup>499</sup> SBC/Ameritech July 24 Application, Kahan Aff. at paras. 83-85.

<sup>500</sup> SBC/Ameritech Nov. 16 Reply Comments at 20.

<sup>501</sup> *Id.*; SBC/Ameritech July 24 Application, Kahan Aff. at para. 83.

<sup>502</sup> SBC/Ameritech July 24 Application at 51. In this regard, the Applicants stress the speed with which such a strategy must be undertaken in today’s increasingly competitive market. Applicants also emphasize the requirement in the multilocation business customer market of providing “near national” coverage (equating to 70-80% of customers’ telecom needs). SBC/Ameritech Nov. 16 Reply Comments at 21.

<sup>503</sup> SBC/Ameritech July 24 Application at 51.

<sup>504</sup> SBC/Ameritech July 24 Application, Kahan Aff. at paras. 86-89.

<sup>505</sup> SBC/Ameritech July 24 Application at 21.

<sup>506</sup> *Id.* at 22.

exchange competition, the Applicants suggest, will pressure interexchange carriers, competitive LECs and the other incumbent LECs to compete not only in their own markets, but also in SBC's and Ameritech's home markets as well.<sup>507</sup> In addition, the Applicants submit that implementation of the National-Local Strategy will inject local exchange competition into 14 major foreign markets<sup>508</sup> and will create a new, major U.S. participant in the global telecommunications marketplace.<sup>509</sup> Finally, the Applicants maintain that a key public interest benefit from the National-Local Strategy's implementation is the creation of thousands of new jobs, both domestically and internationally.<sup>510</sup>

267. *Discussion.* Elsewhere in this Order, we have concluded that the merger proposed by the Applicants portends probable and substantial harm to the public interest, as defined by the goals, values, and purposes of the Communications Act. The National-Local Strategy, Applicants assert, will provide public interest benefits that outweigh these harms. To make their case, the Applicants must also demonstrate that their merger is a reasonably necessary means to enable them to achieve these benefits, i.e. that the benefits are specific to the merger. Should the Applicants be able to pursue the Strategy – or its equivalent – without merging, consumers could achieve the benefits of the National-Local Strategy without suffering the harms of the merger. A mere recitation by the Applicants that they will provide some benefit if and only if their license transfer is approved cannot suffice to show that such a benefit is merger specific. Rather, we need sufficient evidence from the Applicants that the benefit is dependent on the merger if the benefit is to be included in an overall assessment of the effects of the license transfer.

268. In the following subsections, we conclude that the merger is not plausibly necessary to obtain the benefits of this Strategy. That is, we are not persuaded that the National-Local Strategy is a merger-specific benefit. First, we reject the argument that the merger increases the incentive of the two Applicants to pursue an out-of-region strategy. Second, the evidence does not support the Applicants' claim that, absent the merger, they would not have the ability to pursue an out-of-region strategy. Finally, we conclude that even though the National-Local Strategy is not a merger-specific benefit, successful implementation of the National-Local Strategy will bring some benefits to the local exchange marketplace, though not to the extent claimed by the Applicants. The single merger-specific benefit appears to be the increased speed with which the Applicants can expand into the country's top 50 markets. Even this benefit is tempered, however, because SBC effectively is merging with the incumbent in seven of those markets, which generates the substantial harm of eliminating a significant potential competitor in those markets.

269. Our evaluation of the National-Local Strategy centers around two inquiries: (1) Are the benefits promised by the Strategy merger-specific, in that they can be obtained only as a result of the merger? (2) Are the probable benefits consumers will receive from the Strategy

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<sup>507</sup> *Id.* at 7-8.

<sup>508</sup> *Id.* at 26-27.

<sup>509</sup> *Id.* at 85.

<sup>510</sup> SBC/Ameritech July 24 Application at 27; SBC/Ameritech Nov. 16 Reply Comments at 13.

large enough so that these benefits might be weighed, if necessary against the merger's probable harms?

### **1. The Benefits are Not Merger-Specific**

270. We conclude that, whatever benefits might arise from the Applicants' proposed National-Local Strategy, these benefits cannot be used to justify the merger because the merger is not a sufficiently necessary condition -- either of the parties could implement this strategy on their own. The Applicants do not need to merge to become successful out-of-region competitive LECs, nor does their merger increase the likelihood that either or both will seek to implement a National-Local Strategy. We find only one claimed benefit to be merger-specific, and that is the speed with which the Applicants can reach their 50 market goal contemplated in the National-Local Strategy. We conclude that no other benefits of the National-Local Strategy, as it is proposed in the initial application, are merger-specific.

#### **a) The National-Local Strategy is Not Unique**

271. The Applicants maintain that the National-Local Strategy is in some way unique because it is a "significant" out-of-region local exchange strategy.<sup>511</sup> The Applicants in fact submit that it is the very uniqueness of the Strategy that necessitates this merger.<sup>512</sup>

272. We note that in a previous section entitled "Analysis of Competitive Effects in Local Exchange and Exchange Access Services," we concluded that the merger causes a public interest harm by eliminating SBC and Ameritech as among the most significant potential participants in the mass market for local exchange and exchange access services in each other's regions. Additionally, we concluded in the mass market for local exchange services that not only are both firms most significant market participants in geographic areas adjacent to their own regions, but also in out-of-region markets in which they have a cellular presence.<sup>513</sup>

273. As out-of-region competitors, therefore, we consider SBC and Ameritech to be unusually qualified. In this section, however, we address the strategy itself that these unusually qualified competitors plan to implement. We conclude that while the Applicants themselves may

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<sup>511</sup> SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at paras. 24, 26.

<sup>512</sup> The Applicants state that the alternative, attempting to go national on a more incremental basis, entering fewer markets more slowly, would not permit them to respond promptly to requests for proposals from multi-location customers. The Applicants therefore claim that any alternative strategy would at best delay or even preclude the onset of significant new competition by the Applicants for business and residential customers in major and second tier markets. See SBC/Ameritech July 24 Application at 51-52, Kahan Aff. at para. 51, Carlton Aff. at paras. 43-44.

<sup>513</sup> See Section V.B. (Analysis of Competitive Effects). By contrast, we concluded that in the larger business market for local exchange and exchange access services, SBC and Ameritech are only two of a larger number of actual and potential competitors in each other's regions. The merger would thus be less likely to have competitive effects leading to public interest harms.

be particularly strong competitors relative to other new entrants, that their facilities-based strategy for going out-of-region is far from unique.

274. We note that smaller companies are pursuing similar facilities-based strategies offering similar product packages. For example, NEXTLINK claims that its goal is to provide integrated, end-to-end solutions for all of its customers' communications needs over its own network, which currently operates 23 local networks in 38 U.S. cities.<sup>514</sup> Allegiance Telecom, Inc. seeks to be a premier provider of telecommunications services to business, government and other institutional users in major metropolitan areas. Allegiance offers an integrated set of voice and data products to customers in thirteen U.S. cities, with plans to enter eleven more cities for a total of 24 by the end of 2000.<sup>515</sup> Other carriers pursuing multi-market local exchange strategies include: Frontier, which offers facilities-based bundled voice and data services in 23 major markets today;<sup>516</sup> Focal, which offers facilities-based local switched voice services in 29 metropolitan statistical areas;<sup>517</sup> WinStar, which offers facilities-based bundled voice and data services in 30 markets today;<sup>518</sup> and AT&T and MCI WorldCom, which claim to offer facilities-based bundled voice and data services in 90-100 cities reaching 70-90% of all business subscriber lines.<sup>519</sup>

275. We also note that many of these companies have plans to expand into more markets in timeframes comparable to those contemplated by the Applicants. For example, WinStar, a competitive LEC with a market capitalization of only \$2.3 billion, has announced plans to enter, on a facilities-basis, 30 additional major domestic markets in two years and an additional 50 major international markets within five years.<sup>520</sup>

276. The Applicants claim that they are the only major competitive LEC planning to serve the specific 30 out-of-region markets contemplated by their National-Local Strategy. We note, in the aggregate, however, that numerous competitive LECs *already* are providing bundled services in those markets while the Applicants' Strategy is still in the planning stages and will not see commercial roll-out until next year. In fact, Applicants' own research shows that there are numerous competitive LECs in their target out-of-region markets.<sup>521</sup> To put the Applicants' Strategy into perspective, below we provide a matrix<sup>522</sup> of the number of competitive LECs

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<sup>514</sup> NEXTLINK Communications, Inc., May 5, 1999 Prospectus Offering of Class A Common Stock 24 (1999).

<sup>515</sup> Allegiance Telecom, Inc., April 14, 1999 Prospectus Offering of Common Stock 1, 42 (1999).

<sup>516</sup> See SBC Feb. 2 Narrative Response, Exhibit 7 at 1-3.

<sup>517</sup> See SBC Feb. 2 Narrative Response, Exhibit 8 at 1.

<sup>518</sup> See SBC Feb. 2 Narrative Response, Exhibit 10 at 2.

<sup>519</sup> See SBC/Ameritech Nov. 16 Reply Comments at 5, Grubman Aff. at para. 3.

<sup>520</sup> See SBC Feb. 2 Narrative Response, Exhibit 10 at 1; Harry E Blount and Timothy Horan, *WinStar Communications, Inc.*, CIBC Oppenheimer, April 14, 1999, at 1, 4-5. The market capitalization is based on a closing stock price of \$52.125 as of April 13, 1999.

<sup>521</sup> See Appendix B (Summary of Confidential Information and Conclusions).

<sup>522</sup> New Paradigm Resources Group, Inc., 1999 CLEC Report, Chapter 8, pages 28-120 (1999) (New Paradigm 1999 CLEC Report).

operating as of the end of 1998 in each of the 30 out-of-region markets identified by the Applicants.<sup>523</sup>

Market Name	Competitive LECs
Albany, NY	7
Atlanta, GA	20
Baltimore, MD	11
Birmingham, AL	5
Boston, MA	21
Buffalo, NY	5
Cincinnati, OH	5
Denver, CO	15
Greensboro, NC	7
Honolulu, HI	3
Las Vegas, NV	8
Louisville, KY	6
Memphis, TN	7
Miami, FL	12
Minneapolis, MN	7
Nashville, TN	8
New Orleans, LA	10
New York, NY	30
Norfolk, VA	3
Orlando, FL	11
Philadelphia, PA	16
Phoenix, AZ	14
Pittsburgh, PA	4
Portland, ME	3
Providence, RI	3
Rochester, NY	7
Salt Lake City, UT	9
Seattle, WA	13
Tampa/St.Petersburg, FL	13
Washington, DC	22

277. That no single competitive LEC currently offers competitive services in each of the 30 markets misses the point; many of these competitive LECs offer coverage in markets not

<sup>523</sup> SBC will not be the first new entrant in the 30 out-of-region markets it plans to target with the National-Local Strategy, and in many markets, it will not even be in the top ten entrants. According to the New Paradigm Resources Group, Inc. 1999 CLEC Report, there were between 3 and 30 facilities-based competitive LECs already operating in these 30 cities as of end 1998.

targeted by the Applicants, which the Applicants choose to overlook. Additionally, the Applicants' claim that establishing a presence in these top 30 out-of-region markets enhances their ability to compete for the business of large multi-location business customers similarly misses the point. The vast majority of these markets have multiple competitors all vying for the same business customers targeted by the Applicants. We conclude, therefore, that the Applicants' National-Local Strategy is neither unique in scope nor in its primary target customers.

**b) Effect of the Merger on Applicants' Ability to Provide Out-Of-Region Services**

278. The Applicants contend that their ability to carry out the National-Local Strategy is vastly reduced absent the merger.<sup>524</sup> Having concluded *supra* that the Applicants are significant potential competitors in each other's regions as well as in their out-of-region cellular territories,<sup>525</sup> we find to the contrary that each of the Applicants is fully capable of undertaking a strategy of the size and scope of the National-Local Strategy. Dozens of competitive LECs, without the size, resources or assets of either SBC or Ameritech are presently pursuing significant entry plans in multiple markets. Moreover, the record reveals that, of the competitive LECs and several investment analysts interviewed by the Commission,<sup>526</sup> not one believes that a company the size of the proposed merged entity is necessary to succeed as a competitive LEC. We note that the Applicants appear to acknowledge that size is not necessarily commensurate with a carrier's ability to enter or to compete. For example, according to the Applicants, once they begin providing services in the territories of other incumbent LECs, these incumbents will retaliate by competing in the Applicants' territory.<sup>527</sup> Notably, the Applicants do not contend that these incumbent LECs must first merge in order to do so, despite the fact that those other incumbent LECs will be notably smaller than the combined SBC/Ameritech. To assert that these multi-billion dollar Applicants need to merge in order to pursue the National-Local Strategy therefore is contrary to both experience and common sense.

279. Nevertheless, Applicants offer four reasons why this merger is necessary to enhance their ability to implement their Strategy: 1) an insufficient customer base; 2) insufficient

<sup>524</sup> SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at para. 23

<sup>525</sup> See *supra* Section V.B.2. (Local Exchange and Exchange Access Services).

<sup>526</sup> See e.g. Letter from John J. Heitman, e.spire Communications, to Magalie Roman Salas, Secretary, FCC (filed Jan. 11, 1999) (e.spire Jan. 11 *Ex Parte*); Letter from Richard J. Metzger, Focal Communications, to Magalie Roman Salas, Secretary, FCC (filed Jan. 13, 1999) (Focal Jan. 13 *Ex Parte*); Letter from Joseph M. Sandri, Jr., WinStar Communications, Inc., to Magalie Roman Salas, Secretary, FCC (filed March 4, 1999) (Winstar Mar. 4 *Ex Parte*); Letter from Gunnar D. Halley, Teligent, to Magalie Roman Salas, to Magalie Roman Salas, Secretary, FCC, (filed March 5, 1999) (Teligent Mar. 5 *Ex Parte*); Letter from Daniel Gonzalez, NEXTLINK, to Magalie Roman Salas, Secretary, FCC (filed March 9, 1999) (NEXTLINK Mar. 9 *Ex Parte*); Letter from William L. Fishman, RCN Telecom Services, to Magalie Roman Salas, Secretary, FCC (filed March 17, 1999) (RCN Mar. 17 *Ex Parte*); Letter from Ross A. Buntrock, Intermedia, to Magalie Roman Salas, Secretary, FCC (filed March 24, 1999) (Intermedia Mar. 24 *Ex Parte*); Letter from Anna Maria Kovacs, Janney Montgomery Scott, to Magalie Roman Salas, Secretary, FCC (filed Dec. 14, 1999) (Janney Montgomery Scott Dec. 14 *Ex Parte*).

<sup>527</sup> See SBC/Ameritech July 24 Application at 34; SBC Oct. 15 *Ex Parte*, at 2, 13-16.



geographic reach; 3) likelihood of excessive earnings dilution if pursued on a standalone basis; and 4) insufficient managerial and employee talent.

280. We find that geographic reach, while an important consideration in a national or international expansion strategy for a regional or local player, plays at best a modest role in terms of this merger. After all, this merger gives SBC only seven of the 37 additional markets SBC intends to enter to achieve its coverage of the top 50 domestic markets. Had geographic coverage been the principal driver of SBC's expansion plans, SBC could have purchased a competitive LEC such as WinStar, which has facilities already built in 30 of the top markets. Such an acquisition certainly would bring SBC substantially closer to its goal of reaching the top 50 markets than does the Ameritech acquisition.

281. Similarly, we find that insufficient managerial and employee talent, while an important consideration, does not play an important role in this merger. Although SBC picks up over 40,000 employees with this merger,<sup>528</sup> many of whom are experienced managers, if the lack of personnel were the number one issue constraining SBC's ability to deploy a competitive LEC strategy in numerous new markets today, it would not buy an incumbent LEC whose personnel are least likely to have deployed competitive LEC operations in new markets, and who face the prospect of having to move locations to those new markets. Rather, it is more probable it would purchase a competitive LEC with experienced personnel and operations in those markets SBC plans to enter if the need for personnel to run such operations were the major consideration.

282. We therefore focus our discussion on the two reasons that appear to be the key drivers of this merger: an insufficient customer base and the threat of excessive dilution.

### **(1) Insufficient Customer Base**

283. The Applicants contend that the merger is necessary to create a sufficient in-region customer base to follow into out-of-region markets.<sup>529</sup> We conclude, on the basis of substantial marketplace evidence, that the Applicants have failed to demonstrate that they must have almost 50 percent of the nation's Fortune 500 companies headquartered in its regions in order to launch successfully an out-of-region strategy.<sup>530</sup>

284. Specifically, Applicants claim that they need a larger customer base because their out-of-region plan involves a facilities-based entry strategy for which a "sufficiently broad base

<sup>528</sup> Ameritech's 1998 ARMIS 43-02 USOA Report, Table 1-1, Row 830. SBC will pick up an additional 40,912 employees from the Ameritech operating companies, but holding company employees are excluded from this number.

<sup>529</sup> SBC/Ameritech Nov. 16 Reply Comments at 25, Carlton Aff. at para 42. *See also* SBC/Ameritech July 24 Application, Kahan Aff. at paras. 40-41.

<sup>530</sup> Letter from Todd F. Silbergeld, SBC Communications, to Magalie Roman Salas, Secretary, FCC, Attach. D at 3 (filed Feb. 19, 1999) (SBC Feb. 19 *Ex Parte*). *See also* Letter from Wayne Watts, SBC, to Magalie Roman Salas, Secretary, FCC, at 3 (filed Oct. 5, 1998) (SBC Oct. 5 *Ex Parte*). Two hundred twenty-four (224) of the Fortune 500 companies (45%) would be headquartered in the combined companies' regions.

of customer relationships” is needed to support the large capital investments necessary to deploy new switches and networks.<sup>531</sup> Although we recognize that spreading fixed capital costs across a broader number of customers effectively reduces the cost per customer of geographic expansion, we question the Applicants’ assertion that neither company individually has a sufficiently broad and large customer base to venture out-of-region.<sup>532</sup> We note that the Applicants have identified numerous other companies that provide a range of services for business customers on a national or regional basis, including AT&T, e.spire, Focal Communications, Frontier, Intermedia Communications, Level 3, MCI WorldCom, McLeodUSA, NEXTLINK, Qwest, RCN, Sprint, Teligent and Winstar.<sup>533</sup> Although the competitors on this list vary in size, each of these companies operates in multiple markets around the country. Although some may pursue only niche strategies in terms of products offered and customers targeted,<sup>534</sup> we find that most of these companies are pursuing expansionist strategies without business customer bases even approaching the levels of either SBC or Ameritech alone. We also note that the Applicants themselves admit the feasibility of SBC’s entering the 15 largest MSAs out of SBC’s region on its own, presumably with the customer base it has today.<sup>535</sup> Finally, Applicants also claim that their out-of-region ventures will lead other incumbent LECs to invade Applicants’ regions. They do not assert, however, that these incumbent LECs will need to acquire enhanced customer bases before they retaliate, which implies that SBC and Ameritech currently are large enough on a standalone basis to pursue out-of-region strategies.

285. When specific examples are considered, we find that the Applicants’ assertion that going out-of-region requires a large customer base far larger than either currently possesses distorts market reality. The Applicants identify Phoenix, Arizona as an “excellent example” of how the follow-the-customer strategy would work.<sup>536</sup> The Applicants identify over 2,100 Phoenix locations owned or operated by businesses headquartered in the Ameritech and SBC regions. Of these locations, 60% or over 1,250 belong to businesses headquartered in the Ameritech region. The remaining 40% or close to 850 locations belong to businesses headquartered in the SBC region. The Applicants conclude that absent the merger, neither SBC nor Ameritech “would have a sufficiently large customer base to follow into Phoenix.”<sup>537</sup>

286. We find it incredible that neither SBC nor Ameritech has a sufficiently large customer base to enter the Phoenix market on its own. Competitors of far smaller size and

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<sup>531</sup> See SBC/Ameritech Nov. 16 Reply Comments at 24. See also SBC/Ameritech July 24 Application, Kahan Aff. at paras. 5, 14.

<sup>532</sup> SBC/Ameritech July 24 Application at 7 (“Neither company, standing alone, has the breadth of experienced management and skilled technical personnel that such an undertaking requires, and it is simply not possible or feasible for either company alone to rapidly secure such personnel.”). The Applicants state that Ameritech on its own has 91 Fortune 500 firms headquartered in its region, while SBC has 129 such firms headquartered in its region. The merged entity would have 220 Fortune 500 firms headquartered in its region.

<sup>533</sup> SBC Feb. 2 Narrative Response at 7-8.

<sup>534</sup> SBC/Ameritech July 24 Application at 23-24.

<sup>535</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 50.

<sup>536</sup> *Id.* at 52-53.

<sup>537</sup> *Id.*

resources are entering markets of the size of Phoenix on a facilities-basis and with substantially smaller customer bases. For example, as of the end of 1998, 14 facilities-based competitors were already in the Phoenix market.<sup>538</sup> Indeed we doubt that, absent the merger, the Applicants would ignore the competitive threat to their customer bases in-region by not going out-of-region to those markets such as Phoenix where each Applicant would find densely located outposts of many of its in-region customers.

## (2) Excessive Earnings Dilution<sup>539</sup>

287. Applicants maintain that established companies such as SBC and Ameritech are valued by financial markets based on their earnings performance and not on another metric such as cash flow which is typically used to value younger companies with little or no earnings.<sup>540</sup> The Applicants argue that the cost of implementing the Strategy would be too dilutive to earnings for their more conservative-minded shareholders to tolerate.<sup>541</sup> Furthermore, the companies argue that this merger will mitigate the dilutive impact by increasing the shareholder base over which costs can be spread, by increasing the revenue base to absorb the out-of-region costs, and by reducing the number of new markets that the company would have to enter de novo to serve the top 50 markets.<sup>542</sup>

288. First, we question the Applicants' claims regarding the extent of dilution resulting from implementation of the Strategy. We note the Applicants intend to utilize a "smart build" strategy for entering the 30 out-of-region markets. By "smart build," the Applicants contemplate placing multiple switches in each market, and then utilizing available inter-city and local transport capabilities to most efficiently manage their capital. Only where such transport is not available will the Applicants construct their own fiber networks.<sup>543</sup>

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<sup>538</sup> New Paradigm 1999 CLEC Report at 30. These include small competitors, such as GST, ICG and WinStar, as well as large ones, such as AT&T and MCI WorldCom.

<sup>539</sup> Earnings dilution is a financial concept describing a condition in which a diminution occurs in the proportion of income to which each share is entitled. See Brealey and Myers, *Principles of Corporate Finance*, 4<sup>th</sup> Edition at G3. Earnings dilution typically occurs when income falls relative to projected performance due to higher-than-expected costs or lower-than-expected revenues from a project, or when more shares are issued as in a stock offering or stock-for-stock merger. The higher the earnings dilution, the more costly for the company and its shareholders alike to bear.

<sup>540</sup> SBC/Ameritech July 24 Application at 51.

<sup>541</sup> *Id.*

<sup>542</sup> SBC Feb. 2 Narrative Response at 16.

<sup>543</sup> See SBC/Ameritech July 24 Application at 5, Kahan Aff. at paras. 37-39. We note that the Applicants claim that the Strategy contemplates constructing more than 2,900 fiber miles, or between 75 and 125 miles in each of the 30 out-of-region markets (though the Applicants contradict themselves in the SBC/Ameritech July 24 Application at 15 by once referring to route miles). Although new intra-city fiber would be a welcome contribution to the competitive environment in these markets, we must point out the difference between fiber miles and route miles. Fiber miles are the number of miles of fiber strand used in all routes including both lit and unlit fiber. Route miles are the total number of miles of fiber routes. See FCC Fiber Deployment Report for 1997 at 46. In general, multiple fiber strands are placed in a cable, so fiber miles typically exceed route miles of cable laid. Typical competitive LEC intra-city fiber configurations involve cables containing 20 to 200 fiber strands. For year end 1997, reporting competitive LECs on average had deployed 69 fiber strands per route mile of cable. See FCC Fiber

289. We find that this “smart build” strategy, which emphasizes installation of one’s own switches, but delays construction of one’s own fiber capacity until sufficient numbers of customers are won and the economics of demand dictate that such construction makes economic sense, is not unique.<sup>544</sup> To the contrary, numerous other competitive LECs are pursuing such a strategy.<sup>545</sup> This strategy contrasts with either investing up front in fiber in anticipation of recouping the investment in the future, or with pursuing a lease-only strategy whereby entrants lease the fiber as a long-term strategy. The attraction to competitive LECs of the “smart build” strategy over other strategies is the short-term prospect of fast market entry, quick revenue generation, deferral of substantial capital costs and the mitigation of dilution, and the long-term prospect of ramping up one’s own fiber deployment, which facilitates realization of economies of scale, lower variable costs and improved margins. This view is consistent with that of the Applicants as they look to go out-of-region.<sup>546</sup> Even Applicants’ note that their “smart build” approach is analogous to the strategy utilized by competitive access providers when they first entered the local exchange market.<sup>547</sup>

290. We also note that the Applicants predicate their National-Local Strategy on following existing in-region multi-location business customers into out-of-region markets. The existence of a large customer base, which most other competitive LECs lack, reduces the Applicants’ customer acquisition costs relative to what other competitive LECs incur. Furthermore, the Applicants are not forced at the outset to invest in an all-out local market strategy in all 30 markets which most other competitive LECs would be forced to do if they sought to offer services comparable to those in the National Local Strategy. The cost and attendant dilution of the National-Local Strategy, therefore, are much less than they are for most competitive LECs.<sup>548</sup> If it typically takes two to three years for a “smart build” competitive LEC to achieve break even on a cash flow basis in a given market,<sup>549</sup> we would expect that time period to be compressed for the Applicants. On a market-by-market basis, we find that expected

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Deployment Report for 1997 at 41. Using this conversion ratio as a proxy, we calculate that of the 2,900 fiber miles which the Applicants are contemplating deploying out-of-region, these equate to approximately 42 route miles over 30 markets, or an average of 1.5 miles per market. Compare this deployment to the average competitive LEC deployment of 721 route miles of fiber in the first quarter of 1999 alone. See David W. Barden, *Competitive Telecom Services Review*, JP Morgan Equity Research, June 2, 1999, at 10. On a per market basis, this recent fiber deployment far exceeds that proposed by the Applicants. We find that the Applicants’ competitive LEC plans, relative to the plans of other competitive LECs, are very conservative in terms of fiber deployment. Therefore, the Applicants’ market entry costs with regards to fiber should similarly be low, which further supports our finding that the Applicants’ out-of-region plans are not excessively dilutive.

<sup>544</sup> David W. Barden, *Competitive Telecom Services Review*, JP Morgan Equity Research (June 2, 1999) at 10.

<sup>545</sup> Examples include: Allegiance Telecom, ALLTEL’s competitive LEC business, Commonwealth Telephone Enterprises’ competitive LEC business, Hyperion Telecommunications, MGC Communications and US LEC.

<sup>546</sup> See Appendix B; SBC/Ameritech July 24 Application, Kahan Aff. at para. 39.

<sup>547</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 42.

<sup>548</sup> Frank Governali and Kathryn Littlefield, *SBC Communications*, Credit Suisse First Boston Equity Research, May 14, 1998, at 7 (Credit Suisse First Boston Equity May 14 Report).

<sup>549</sup> Daniel Reingold, *Merrill Lynch Global Securities Research*, ALLTEL CORP., May 19, 1999, at 3. For example, ALLTEL “is targeting a 2-3 year EBITDA breakeven goal for its competitive LEC markets, in line with our expectations for other ‘smart build’ competitive LECs.”

dilution for the Applicants is not only *not* excessive, it is a substantial improvement upon the earnings dilution likely experienced by competitive LECs.

291. Second, although the merger is projected to be accretive to earnings after 2001, even the relative dilution in the early years suggests that the National-Local Strategy in and of itself is not excessively or intolerably dilutive for the Applicants and their shareholders. Although we note that the National-Local Strategy may seem dilutive *on an aggregate basis* for all 30 markets, the Applicants provided guidance to Wall Street at the time of the merger announcement that suggested that the Strategy would dilute earnings by no more than one percent per year for the next several years.<sup>550</sup> According to the Applicants, SBC would experience approximately twice the dilution if it implemented the National-Local Strategy without the merger,<sup>551</sup> implying earnings dilution of two percent per year over the next several years. This proposed merger between SBC and Ameritech, by contrast, is projected to dilute earnings by seven percent in 2000 and by three percent in 2001 due to the issuance of additional shares necessary to pay the approximately 27% premium.<sup>552</sup> Nevertheless, shareholders for both companies approved this proposed merger.

292. Third, we note that the Applicants each have pursued substantial and dilutive projects in the past. For example, SBC's purchase of Pacific Telesis in 1997 was valued at \$17 billion and was earnings dilutive for two years to an extent comparable with the currently proposed merger.<sup>553</sup> In terms of internal projects, SBC and its Pacific Telesis subsidiary have spent almost \$900 million in the last three years on capital expenditures for their PCS business. EBITDA<sup>554</sup> losses in that time period were approximately \$360 million, with losses of \$229 million in 1997 alone.<sup>555</sup> Similarly, Ameritech's cable overbuilds involve substantial capital expenditures and are expected on a franchise-by-franchise basis to be earnings dilutive for the first four years.<sup>556</sup> More specifically, analyst estimates of Ameritech's cable business project capital expenditures of \$3.5 billion over the next 10 years and EBITDA losses for 1999 alone of \$159 million.<sup>557</sup> By comparison, the National-Local Strategy calls for capital expenditures of

<sup>550</sup> Credit Suisse First Boston May 14 Report at 7.

<sup>551</sup> SBC/Ameritech Nov. 16 Reply Comments, Grubman Aff. at para. 8. We note that the Applicants refused to submit for the public record any documentation supporting Grubman's computation of the National-Local Strategy's dilutive impact absent the merger.

<sup>552</sup> SBC/Ameritech Nov. 16 Reply Comments, Grubman Aff. at para. 8. The 27% premium to Ameritech's closing price of \$43.875 was as of May 8, 1998. See SBC Investor Briefing No. 200, *SBC Communications and Ameritech to Merge*, May 11, 1998 at 8.

<sup>553</sup> SBC Feb. 19 *Ex Parte*, Attach. A at 13, Attach. F at 7.

<sup>554</sup> EBITDA is Earnings Before Interest Taxes Depreciation and Amortization. EBITDA is an income statement calculation that serves as a proxy for operating cash flow.

<sup>555</sup> Stephanie Comfort and Stephen Flynn, *The Financial Models*, Morgan Stanley Dean Witter, Oct. 9, 1998 at 22-23.

<sup>556</sup> Anna-Maria Kovacs, *Progress Report on Ameritech*, Janney Montgomery Scott, April 14, 1998, at 4.

<sup>557</sup> Stephanie Comfort and Stephen Flynn, *The Financial Models*, Morgan Stanley Dean Witter, Jan. 21, 1999 at 6-8. Ameritech's cable capital expenditures translate into approximately \$450 per home passed.

more than \$2 billion over ten years, or approximately \$200 million per year.<sup>558</sup> We conclude that shareholders of both companies have weathered and tolerated comparable-dilution from expensive projects in the past. We remain unconvinced that shareholders would not be so inclined in the context of the National-Local Strategy.

293. Finally, we reject the Applicants' argument that the merger mitigates the Strategy's dilutive impact by reducing the number of new markets that the company has to enter *de novo* to serve the top 50 markets. SBC's merger with Ameritech reduces from 37 to 30 the number of new markets that SBC needs to enter out-of-region to attain the top 50 markets goal. The associated capital expenditures required for market entry therefore would not apply to these seven markets. Most of the operating expenses, by contrast, would apply since they largely represent ongoing costs that would occur post-market entry. Although the reduction in overall capital expenditures from entering seven fewer markets is directly tied to the merger, the merger itself involves a substantial premium of almost \$13 billion paid by SBC to Ameritech in the form of additional shares issued. So while the Applicants argue on the one hand that they need more shareholders to reduce earnings dilution (by spreading the costs of the National-Local Strategy over a larger base), they admit that the very method of gaining these shareholders, via this merger, will dilute earnings due to the issuance of more shares for the premium paid. We cannot fully separate the increased cost to shareholders of the premium paid from the decreased cost to shareholders due to the merger benefit of reducing the number of new markets the combined company will enter out-of-region. In short, we conclude that the reduction in cost is countered in part by the increase in cost from the premium paid. We also conclude that the reduction in cost from having to enter seven fewer markets comes at the great expense of losing a potential competitor in those markets.

#### **c) The Merger Does Not Enhance Applicants' Incentive to Enter Out-of-Region Markets**

294. Having concluded that the Applicants individually are able today to pursue substantial out-of-region strategies without this merger, we turn to whether the merger in some way enhances the Applicants' incentive to go out-of-region. Where ability in this context refers to whether each Applicant has the wherewithal to pursue a standalone competitive LEC strategy, incentive, by contrast, refers to whether the Applicants have an economic desire to do so.

295. The fundamental motivation for the National-Local Strategy, according to the Applicants, is the recognition that they must compete for the business of large national and global customers both in-region and out-of-region."<sup>559</sup> They maintain that they "cannot remain idle while [their] competitors capture the huge traffic volumes generated by a relatively small

<sup>558</sup> See SBC/Ameritech July 24 Application, Kahan Aff. at paras. 57-58; SBC/Ameritech Nov. 16 Reply Comments, Grubman Aff. at para. 8. The Applicants in fact intend to front-load the brunt of their capital spending related to the National-Local Strategy over the first seven years of the 10-year plan.

<sup>559</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 13.

number of larger customers.”<sup>560</sup> For Southwestern Bell Telephone Company, one of SBC’s operating companies, the top one percent of its business customers represent eight percent of the company’s total revenues.<sup>561</sup> For Ameritech, the top one percent represent eleven percent of the company’s total revenues.<sup>562</sup> SBC asserts that it has lost a significant amount of existing business, as well as new business opportunities, to competitive LECs.<sup>563</sup> Ameritech maintains that, although it rarely loses 100% of an in-region large customer’s entire telecommunications spending, it does lose out on potential revenue because it is prohibited from participating in the growth of new services or in bidding for the higher-margin services.<sup>564</sup>

296. The Applicants fail to provide sufficient evidence to persuade us of the extent of the competitive threat that they face. Although the Applicants provide aggregate data related to resold and unbundled loops,<sup>565</sup> they provide little data in the way of lost customers, number of lines lost per customer, line additions that might offset line losses.<sup>566</sup> With regard to the provision of end-to-end services to large business customers, SBC claims it does not have the data necessary to calculate the percentage of its or Ameritech’s business customers, or business opportunities, that either company has lost to those carriers that currently offer and market end-to-end service to business customers.<sup>567</sup> Similarly, Ameritech argues that it has no information on SBC’s competitive losses to those same carriers, and that it has not previously calculated such losses for itself, though it presumes that they are considerable.<sup>568</sup> We conclude that, although the Applicants may be suffering some lost lines to their competitors, these losses are not occurring at such a rate as to lead to disinvestment and/or rate increases, as the Applicants suggest.<sup>569</sup>

297. We further find misleading the presumption that Applicants must cover 70-80% of their large business customers’ local and long distance expenditures in order to compete to retain those customers.<sup>570</sup> The Applicants claim that a local presence in the top 50 markets with local exchange offerings is critical to compete. Yet, there is evidence to suggest that local exchange service is less important relative to long distance services for these large business customers. For example, one noted Wall Street analyst reports that, of the \$82 billion in switched telephony revenues generated by large and medium businesses in 1998, approximately

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<sup>560</sup> *Id.*

<sup>561</sup> *Id.* Though Kahan was not explicit, it is our assumption, based on the SBC/Ameritech’s Application filing date of July 24, 1998, that the figures represent 1997 results.

<sup>562</sup> SBC/Ameritech July 24 Application, Weller Aff. at para. 21. Results are for 1997.

<sup>563</sup> SBC Feb. 2 Narrative Response at 7.

<sup>564</sup> Response of Ameritech Corporation to the FCC’s Jan. 5, 1999 Request for Documentary Material, February 2, 1999, at 4 (Ameritech Feb. 2 Response).

<sup>565</sup> See SBC/Ameritech July 24 Application at Tables 1-10.

<sup>566</sup> The Applicants provide some data related to line additions but only at an aggregate level for *all* Regional Bell Operating Companies and for the universe of public competitive LECs. See SBC/Ameritech July 24 Application, Carlton Aff. at 9.

<sup>567</sup> SBC Feb. 2 Narrative Response at 7.

<sup>568</sup> Ameritech Feb. 2 Response at 48.

<sup>569</sup> SBC/Ameritech July 24 Application at 42.

<sup>570</sup> See SBC Feb. 2 Narrative Response at 11; SBC/Ameritech Nov. 16 Reply Comments, Kahan Aff. at para. 16; SBC/Ameritech July 24 Application, Kahan Aff. at para. 48, Carlton Aff. at para. 16.

75% were for long distance/international services and the remaining 25% were for local exchange services.<sup>571</sup>

298. None of this, however, is to deny that the Applicants clearly have the incentive to enter out-of-region markets and to gain section 271 approval absent the merger. Not only are the Applicants at a competitive disadvantage in the long distance voice market, they are at serious disadvantage to large and small competitive LECs alike in the data market where over 85% of large and medium business customer expenditures are for long-haul services.<sup>572</sup> We find, therefore, that the Applicants' suggestion that the merger and consequent pursuit of the National-Local Strategy gives them added incentive to meet the necessary market opening conditions in-region to achieve section 271 approval<sup>573</sup> is inconsistent with the market reality.

299. Finally, we note that evidence of prior out-of-region activity by both Applicants suggests that each already has exhibited the incentive to expand absent this merger.<sup>574</sup> We already concluded above that Ameritech's Managed Local Access Program gave Ameritech both the incentive and capability to become a significant potential entrant serving large businesses in certain markets in California, Missouri and Texas. Additionally, we concluded that Ameritech would have entered the St. Louis residential market with a wireline/wireless service offering but for the merger with SBC. We concluded that SBC had the incentive and capabilities to make it a significant potential market participant in the mass market for local services in Chicago.<sup>575</sup> We also note that SBC's acquisition of SNET led one noted Wall Street analyst to conclude that SNET would be the vehicle by which SBC would attack the Northeast integrated services markets, New York and Boston in particular.<sup>576</sup>

300. We find that the Applicants, irrespective of this merger, have demonstrated definitively that they have a critical need to respond to losses in the business market by expanding their geographic reach and providing a full suite of telecom services. We further find that the Applicants already have acted on this incentive, as demonstrated by their out-of-region plans mentioned above. We conclude, therefore, that the Applicants' incentive to expand out-of-region is demonstrable and substantial absent this merger, and that the merger can do little to enhance this incentive.

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<sup>571</sup> Jack B. Grubman and Christine Gochuico, *Review of Our Position on RBOCs*, Salomon Smith Barney Equity Research, March 11, 1999 at 4-5 (Salomon Smith Barney March 11 Report).

<sup>572</sup> Salomon Smith Barney March 11 Report at 4-5.

<sup>573</sup> SBC Oct. 15 *Ex Parte* at 2, Attach. B at 7.

<sup>574</sup> According to the SBC/Ameritech July 24 Application, Kahan Aff. at para. 69, Applicants admit that they have significant experience in competing out-of-region. SBC submits that it has been an effective competitor out-of-region in the wireless market since 1987. Ameritech, too, has competed out-of-region with its nationwide alarm monitoring business.

<sup>575</sup> See Section V.B.2.c)(1) (Mass Market).

<sup>576</sup> Frank Governali, *SBC Communications*, Credit Suisse First Boston Equity Research, Jan. 7, 1998 at 2 (Credit Suisse First Boston Equity Jan. 7 Report). Mr. Governali also postulated that with SNET vulnerable to competitive entry by neighboring Bell Atlantic, that "the best defense is an effective offense" and that he expected SBC "to launch in the New York and Boston markets soon after the SBC/SNET merger closing."



## 2. Magnitude of the Claimed Benefits

301. We have concluded that the Applicants' out-of-region strategy is neither dependent on the merger, nor unique. We also have concluded that the merger in and of itself does not materially enhance the Applicants' already substantial abilities and incentives to pursue out-of-region strategies on an individual basis. Thus, we find that the single primary benefit of the merger, in the context of the National-Local Strategy, is speed. The Applicants can achieve their goal of establishing a presence in the top 50 U.S. markets somewhat faster by acquiring Ameritech than by rolling out competitive services in Ameritech's present markets as well as the additional 30 markets outside of Ameritech's and SBC's territories. Applicants claim that faster implementation of the Strategy materially increases the likelihood that the Strategy will be successful.<sup>577</sup>

302. We next evaluate the magnitude of actual benefits resulting from an accelerated implementation of the Applicants' National-Local Strategy. The Applicants maintain that the benefits are substantial and accrue to business and residential customers alike both out-of-region, as well as in-region. In the following subsections, we evaluate the Applicants' arguments, focusing on a) the Strategy's dependency on interLATA authority, and b) the Applicants' claims of public interest benefits resulting from the National-Local Strategy.

### **a) The National-Local Strategy is Dependent on In-Region InterLATA Authority<sup>578</sup>**

303. The Applicants assert that the National-Local Strategy "is predicated on SBC/Ameritech's ability to offer a package of interLATA voice and data services" both in-region and out-of-region.<sup>579</sup> Consequently, this Strategy requires them to obtain authority to provide in-region long distance.<sup>580</sup> Without section 271 approval to offer long distance voice and data services, the Applicants would suffer from the same product constraints that prevent them today from competing for all of the voice and data business of their customers. For example, Applicants are already disadvantaged in responding to requests for one-stop shopping capabilities due to, among other factors, interLATA limitations.<sup>581</sup> We conclude, therefore, that for the National-Local Strategy to be successfully implemented, the Applicants' own evidence indicates that they must possess and offer a full suite of services, which in turn is dependent not on the merger, but on the Applicants gaining section 271 approval in-region.

<sup>577</sup> SBC Feb. 2 Narrative Response at 16.

<sup>578</sup> Section 271 says "neither a Bell operating company, nor any affiliate of a Bell operating company, may provide interLATA services except as provided by this section." A BOC may provide interLATA service only once it has met the requirements outlined in section 271, including complying with the competitive checklist. 47 U.S.C. § 271.

<sup>579</sup> SBC Oct. 15 *Ex Parte* at 10.

<sup>580</sup> SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at para. 80.

<sup>581</sup> See Letter from Marian Dyer to Magalie Roman Salas, March 4, 1999 at 4, Letter from Antoinette Cook Bush to Magalie Roman Salas, Feb. 1, 1999 at 5.

304. Applicants state that the “relationship between the receipt of section 271 authority and the implementation of the Strategy is a question of timing.”<sup>582</sup> We note that this, in turn, will affect the timing of the National-Local Strategy roll-out. In February 1999, SBC claimed that it expects to have section 271 authority in its largest states within the next 12-18 months, which is consistent with its current plans for the roll-out of the Strategy in the initial markets,<sup>583</sup> which brings us to February to August 2000. SBC also anticipates that, once section 271 authority is obtained in its largest states, it will secure the authority in the remaining states “in short order.”<sup>584</sup> In contrast, Ameritech makes no claim about when it anticipates obtaining section 271 authority. Although SBC plans to begin the roll-out of the Strategy before it has received section 271 authority in all of the combined companies’ states, it has not determined a “minimum” number of such states.<sup>585</sup>

305. Furthermore, according to the Applicants, the economics of the merger require that the merged company rapidly receive interLATA authority.<sup>586</sup> Through the National-Local Strategy, the Applicants aim to serve successfully the needs of multi-location customers for local, long distance, data, Internet and customized private network services. According to a recent report produced by a Wall Street bank, long distance accounts on average for approximately 80% of blended voice and data revenues generated by large business customers, with long distance representing 85-90% of data for these customers.<sup>587</sup> Data is outgrowing voice as a percentage of revenues 15 to 1, and, therefore, interLATA authority is critical in order to participate in this growing demand for data transmission.<sup>588</sup> According to one noted Wall Street analyst, those BOCs that get into long distance earlier will have a better chance of protecting their large business accounts and penetrating further their large business accounts.<sup>589</sup> Clearly, the inability to provide long distance services will create an enormous gap in the bundled product offering and thus missed revenue opportunities.

306. Although it is understandable that the Applicants’ plans are not yet fully determined, the uncertainty regarding section 271 approvals makes it difficult for us to evaluate the extent of the claimed benefits and makes them speculative at best. Although we expect the Applicants to push aggressively to meet their roll-out schedule, it is impossible to predict obstacles they may encounter in obtaining their section 271 authority. Any delays to section 271 approvals impede the roll-out of the National-Local Strategy. Such delays to the Strategy, therefore, result in delayed benefits to consumers. We therefore conclude that the dependency of the National-Local Strategy on section 271 approvals is a substantial constraint to both the full implementation and success of the plan.

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<sup>582</sup> SBC Feb. 2 Narrative Response at 34.

<sup>583</sup> *Id.*

<sup>584</sup> *Id.*

<sup>585</sup> *Id.* at 35.

<sup>586</sup> Carlton Oct. 15, 1999 Aff. at 2.

<sup>587</sup> Salomon Smith Barney Equity Mar. 11 Report at 5

<sup>588</sup> *Id.* at 4.

<sup>589</sup> *Id.* at 6.

**b) Analysis of Applicants' Claims Regarding the Effect of the National-Local Strategy on Competition**

**(1) Out-of-region Competition**

307. The Applicants argue that their National-Local Strategy will benefit business and residential customers by offering them a significant, new, facilities-based competitive choice for a fully-integrated package of services.”<sup>590</sup> Also, according to the Applicants, the addition of another entrant will force other incumbent LECs, whose markets the Applicants plan to enter, to respond by expediting their own efforts to provide in-region long distance.<sup>591</sup>

308. *Large and Mid-Size Businesses.* Applicants argue that the only carriers currently competing on a national-local basis for the 1,000 largest business customers in America are the vertically-integrated interexchange carriers. The Applicants, therefore, maintain that the addition of another entrant, the merged SBC/Ameritech, would bring more competition to these customers seeking end-to-end solutions locally, nationally and globally.<sup>592</sup>

309. The addition of another entrant to these new markets should benefit the competitive landscape in those markets. We question, however, the extent of the benefit. Even the Applicants admit that the large business and government customers enjoy the largest number of options for their local exchange and other telecommunications needs.<sup>593</sup> They state that “[t]hese are the customers most avidly pursued by the competitive LECs.”<sup>594</sup> The Applicants further state that SBC’s National-Local Strategy “is only one of several recent responses” to new competitive dynamics in the telecommunications industry.<sup>595</sup> As examples, the Applicants cite competitive LECs that are pursuing similar strategies and targeting customers in similar geographic markets: Allegiance Telecom, AT&T, Covad, e.spire, Electric Lightwave, Focal, GST Telecommunications, Hyperion, ICG Communications, Intermedia Communications, Sprint, Time Warner Telecom, WinStar, and MCI WorldCom.<sup>596</sup>

310. We find that the Applicants’ National-Local Strategy has substantial company in competitors that have not only announced, but also deployed, facilities in the geographic markets and to serve the customer base contemplated by the Applicants. We conclude, therefore, that the benefits of an additional entrant targeting the large/medium business customer base in the top 50 markets are modest.<sup>597</sup>

<sup>590</sup> SBC/Ameritech Nov. 16 Reply Comments at 8.

<sup>591</sup> SBC Oct. 15 *Ex Parte* at 15.

<sup>592</sup> SBC/Ameritech July 24 Application, Schmalensee and Taylor Aff. at para. 16.

<sup>593</sup> SBC/Ameritech July 24 Application at 61.

<sup>594</sup> *Id.*

<sup>595</sup> SBC/Ameritech July 24 Application, Carlton Aff. at para. 36.

<sup>596</sup> *Id.*

<sup>597</sup> Because the out-of-region entry is not merger-specific, this modest benefit overstates the merger’s value.

311. *Residential Customers and Small Businesses.* Applicants contend that out-of-region small business and residential customers also will benefit from SBC/Ameritech's entry as an additional facilities-based entrant providing local, long distance and data services.<sup>598</sup>

312. Specifically, the Applicants plan to target "about 25 percent of the total residential and small business customers in out-of-region areas and expect to service 16.5 percent of this target group after 10 years."<sup>599</sup> This translates into an overall penetration rate of four percent of the residential customers in these 30 markets and closer to six percent of the small businesses in these markets. The residential customers that the Applicants will target are heavy users of telecommunications services that are most likely to want bundles of local exchange, long distance and other services.<sup>600</sup> The Applicants initially plan to serve these residential customers primarily with a mix of UNEs and later via unbundled loops, with a small portion being served by resale.<sup>601</sup> The Applicants contend that a significant percentage of residential and small business customers are within reach of the first out-of-region offices that the merged company plans to equip with switches and fiber.<sup>602</sup>

313. We find that the Applicants' provide little evidence to support these assertions. The Applicants claim that a significant percentage of residential and small business customers are near central offices first targeted by the Strategy; yet they provide no supporting evidence, with the exception of a few maps depicting two geographic markets, one of which is not even slated to be in the first phase of market roll-outs. We therefore have no basis to determine how many residential and small business customers are likely to benefit from the Applicants' National-Local Strategy, or when they will benefit.

314. We also find that the Strategy contemplates targeting only the top quartile of residential customers, based on telecommunications expenditures.<sup>603</sup> While we are encouraged by the promise of greater residential competition in these markets, this is not, as the Applicants suggest, the panacea for residential competition intended by the 1996 Act.<sup>604</sup>

<sup>598</sup> SBC/Ameritech July 24 Application, Schmalensee and Taylor Aff. at para. 6.

<sup>599</sup> SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at para. 84.

<sup>600</sup> SBC/Ameritech Nov. 16 Reply Comments, Kahan Aff. at para. 29. The Applicants provide data suggesting that high users "are equally distributed across all income levels." See Letter from Wayne Watts, to Magalie Roman Salas, Secretary, FCC at 1 (filed Oct. 6, 1998) (SBC Oct. 6 *Ex Parte.*); SBC/Ameritech Nov. 16 Reply Comments, Kahan Aff. at paras. 29-30.

<sup>601</sup> SBC Feb. 2 Narrative Response at 26.

<sup>602</sup> SBC/Ameritech Nov. 16 Reply Comments at 9.

<sup>603</sup> SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at para. 84.

<sup>604</sup> Rather, this Strategy represents to a great degree the strategies pursued by other competitive LECs targeting small and medium business customers that can and do sign up residential customers that are proximate to the competitive LEC's facilities. Examples of such carriers include: Cox Communications, McLeodUSA, Teligent and WinStar. See SBC/Ameritech Nov. 16 Reply Comments, Carlton Aff. at para. 36.

## (2) In-region Competition

315. The Applicants' claims that their merger will stimulate increased in-region competition are not fully persuasive either. They state that their National-Local Strategy will put the company in direct competition with all major interexchange carriers, incumbent LECs and other competitive LECs outside its region.<sup>605</sup> Consequently, the Applicants believe that their out-of-region expansion will also generate competitive responses from these competitors who will attempt to follow their customers into SBC's territory.<sup>606</sup> More specifically, the Applicants based the National-Local Strategy on the assumption that "incumbent BOCs" in particular would have to respond to defend not only their business in their own region, but in the Applicants' regions, as well.<sup>607</sup> In support of this contention, the Applicants cite economic literature suggesting that actions by one firm might have a "demonstration effect" that validates the firm's strategy for other firms, thereby reducing the risk and uncertainty to those other firms of adopting similar strategies.<sup>608</sup> The Applicants expect, therefore, other BOCs to retaliate by competing initially for large business customers in SBC-Ameritech territory<sup>609</sup> in an attempt to follow select customers or by undertaking efforts to achieve similar economies of scale, scope and geographical diversity as the new SBC.<sup>610</sup>

316. Of course, the Applicants cannot have it both ways. On the one hand, they argue that the merger is the catalyst for their own out-of-region expansion. On the other, they maintain that their own expansion will trigger imitative retaliatory responses by other BOCs. For other BOCs to pursue a similar out-of-region strategy, the Applicants' own logic dictates that other BOCs, too, will need to merge to facilitate their expansion.

317. Furthermore, while we are encouraged by the promise of greater competition, we once again question the extent of such competition due to retaliation in in-region markets. First, we are skeptical that residential customers will benefit from retaliatory responses that likely will target large business customers, at least initially. Second, we reiterate that the Applicants themselves have said that the large business market already enjoys the largest number of competitive options. It seems to us that retaliatory responses, therefore, would not have a substantial impact. We note that even the Applicants share this view.<sup>611</sup>

### B. Efficiencies

318. We concluded above that the Applicants' pursuit of the National-Local Strategy, and the associated benefits to local exchange markets resulting from this Strategy, are largely not merger-specific. In this section, we evaluate the second component of the Applicants' claimed

<sup>605</sup> SBC/Ameritech July 24 Application at 24-25.

<sup>606</sup> See SBC/Ameritech July 24 Application at 34; SBC Oct. 15 *Ex Parte* at 2, 13-16.

<sup>607</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 88.

<sup>608</sup> SBC Oct. 15 *Ex Parte* at 2.

<sup>609</sup> SBC/Ameritech July 24 Application, Schmalensee and Taylor Aff. at para. 16.

<sup>610</sup> SBC/Ameritech July 24 Application, Kahan Aff. at para. 88.

<sup>611</sup> See Appendix B (Summary of Confidential Information and Conclusions)

benefits -- efficiencies resulting from the merger in the form of revenue enhancements and cost savings.

319. In the *Bell Atlantic-NYNEX Merger Order*, the Commission outlined the types of efficiencies that it would consider as the public interest benefits of a proposed merger.<sup>612</sup> The Commission generally recognized that efficiencies generated through a merger can mitigate public interest harms if such efficiencies enhance the merged firm's ability and incentive to compete and, therefore, result in lower prices, improved quality, enhanced service or new products. The Commission further noted, however, that beneficial efficiencies include only those efficiencies that are merger specific, *i.e.*, those that would not be achievable but for the proposed merger. Thus, the Commission held that efficiencies that can be achieved through means less harmful to the public interest than the proposed merger cannot be considered to be true merger benefits. The Commission further stated that efficiencies are particularly significant if they improve market performance in a relevant market and thereby reduce the harms otherwise presented by the proposed merger. The Commission recognized also, that in order to mitigate public interest harms, efficiencies cannot result from anti-competitive reductions in output or service.

320. The Commission also recognized in the *Bell Atlantic-NYNEX Merger Order* that efficiencies resulting in reductions to marginal costs, as opposed to fixed or overhead costs, were more likely to offset unilateral or coordinated effects by counteracting the merged firm's incentive to elevate price, or enhancing the incentive of a maverick firm to lower price or by creating a new maverick firm.<sup>613</sup> The Commission determined in that proceeding that only a small fraction of the Applicants' asserted costs savings qualified, in that they reduce marginal costs, rather than fixed or overhead costs.<sup>614</sup>

321. As the Commission has previously noted, the Applicants bear the burden of showing both that the merger-specific efficiencies will occur, and that these efficiencies and any other public interest benefits sufficiently offset any harms resulting from the merger such that the Commission can conclude that the transaction is in the public interest.<sup>615</sup> Thus, Applicants cannot carry their burden if their efficiency claims are vague or speculative, and cannot be verified by reasonable means.<sup>616</sup> Therefore, the public interest benefits of a merger include any efficiencies arising from the transaction if such efficiencies are merger-specific, are sufficiently likely and verifiable, and are not the result of anti-competitive reductions in output or increases in price.<sup>617</sup>

<sup>612</sup> *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20063-64, para. 158.

<sup>613</sup> *Id.* at 20066-67, para. 169; *1997 Horizontal Merger Guidelines Revisions*.

<sup>614</sup> *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20066-67, paras. 169-170. The Commission found that procurement savings reduce the cost of incremental inputs, thereby reducing marginal cost. Savings in the cost of providing long distance services, to the extent that they represent real productive efficiencies, also represent a reduction in marginal cost.

<sup>615</sup> *Id.*

<sup>616</sup> *Id.*

<sup>617</sup> *Id.*

322. The Applicants maintain that the merger will produce significant cost savings and additional revenues due to synergies in new product development and marketing, purchasing discounts, and the elimination of duplication.<sup>618</sup> According to the Applicants, the resulting increased cash flow will make the combined company a more effective competitor, enhance and expand services to existing customers, and help support the financial requirements for the merged company's in-region, out-of-region, and global plans.<sup>619</sup> The Applicants estimate that by the third year after the closing of this merger, the merger will enable the combined company to realize total efficiency gains on an annual basis of \$2.5 billion, including almost \$800 million in additional revenues and over \$1.7 billion in cost savings.<sup>620</sup>

323. Although we conclude that this merger would expedite the achievement of many of the Applicants' claimed efficiencies, we find that only a portion of them are indeed merger-specific. We further find that, of those efficiencies that are merger-specific, fewer still are efficiencies that can be passed through to consumers in a verifiable fashion. Because we already have concluded in this Order that this merger, absent conditions, is likely to result in substantial harms to the public interest, we conclude here that the claimed efficiencies that are merger-specific are not sufficient to outweigh these public interest harms.

### 1. Cost Savings

324. The Applicants claim that the proposed merger will produce annual cost savings of \$1.43 billion, which includes \$1.17 billion in expense savings and \$260 million in capital savings.<sup>621</sup> These cost savings will be realized in the areas of administrative overhead, support functions and telephone company operations.

325. The claimed efficiencies fall into several categories, including: 1) elimination of duplicative or redundant personnel or functions, 2) economies of scale, 3) economies of scope, and 4) adoption of best practices.<sup>622</sup> Specifically, the Applicants assert that the largest cost savings will come from support operations (\$771 million), such as volume discounts on equipment purchases (\$381 million) and consolidation of billing/ordering functions (\$227 million).<sup>623</sup> The Applicants also project cost savings of \$313 million from combining the operations of the SBC and Ameritech telephone operating companies. According to the Applicants, such savings will be derived from provisioning and maintenance (\$115 million), switching operations and network engineering (\$45 million), and other miscellaneous sources (\$153 million).<sup>624</sup> The Applicants also claim cost savings from combining administrative

<sup>618</sup> SBC/Ameritech July 24 Application at 37.

<sup>619</sup> SBC/Ameritech July 24 Application at 38, Kaplan Aff. at para. 32.

<sup>620</sup> SBC/Ameritech July 24 Application at 38, Schmalensee and Taylor Aff. at para. 12, Kaplan Aff. at paras. 7, 17.

<sup>621</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 17.

<sup>622</sup> SBC/Ameritech July 24 Application, Schmalensee and Taylor Aff. at para. 11, Kaplan Aff. at para. 17.

<sup>623</sup> SBC/Ameritech July 24 Application, Kaplan Aff. para. 20.

<sup>624</sup> *Id.* at paras. 21, 23.

functions (\$201 million)<sup>625</sup> and from combining the two companies' activities in businesses such as Yellow Pages, wireless service, and Internet service (\$146 million).<sup>626</sup>

326. We find that certain types of cost savings are indeed merger-specific. For example, elimination of duplicative or redundant administrative functions, or the reduction in future equipment purchases,<sup>627</sup> are direct consequences of the merger. The same is true for some types of best practices, such as when superior methods of provisioning service and maintaining operations are transferred between companies, and economies of scale or scope that could not be achieved but for the merger.

327. Although such cost savings may be merger-specific, verifiable and even likely, some may be the result of decreases in output. For instance, in *Bell Atlantic-NYNEX*, we found that the elimination of parallel research and development efforts would eliminate a form of non-price competition in which firms attempt to differentiate products either in function or quality.<sup>628</sup> Both SBC and Ameritech, like Bell Atlantic and NYNEX, engage in research and development and the merger, by consolidating these functions, could reduce this competitive differentiation.

328. Additionally, although some cost savings may be merger-specific, verifiable and even likely, they may not necessarily be passed through to consumers in the form of lower prices or new or improved services.<sup>629</sup> For example, elimination of a redundant controller is merger-specific. It is verifiable and indeed quite likely. But such a reduction in fixed costs, however, may or may not be passed on to consumers. In the absence of explicit pass-throughs which are publicly committed to by the Applicants, we find it difficult to evaluate just how much of such cost savings actually would benefit the public interest.

329. The redundant controller example highlights a general problem - although the Applicants have assigned dollar amounts to the various claimed cost savings, they provide little supporting evidence to persuade us that these savings will occur or, if so, in what magnitude. The Applicants maintain that their prior experience with the Pacific Telesis merger should serve as a useful indicator of their ability to fulfill their cost savings projections.<sup>630</sup> Although we recognize SBC's success with realizing synergies from the Pacific Telesis merger, prior experience is not a sufficient substitute for rigorous analysis of the facts or presentation of

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<sup>625</sup> *Id.* at para. 24.

<sup>626</sup> *Id.* at para. 25.

<sup>627</sup> An example of this is the claim by the Applicants that this merger would enable them to consolidate two different methods of acquiring and maintaining switches into one. Since Ameritech outsources its switch engineering functions while SBC performs these functions in-house, the merger would enable the combined company to take advantage of scale economies in performing these functions. See SBC/Ameritech July 24 Application, Gilbert and Harris Aff. at para. 43.

<sup>628</sup> *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20067, para. 171.

<sup>629</sup> In fact, the Applicants even admit that "[o]f the merger cost savings, some will go to stockholders." See SBC/Ameritech July 24 Application, Schmalensee and Taylor Aff. at para. 17.

<sup>630</sup> SBC/Ameritech July 24 Application at 40, Gilbert and Harris Aff. at paras. 54-59.



persuasive evidence. Without sufficient evidence to support their claimed cost savings, we find it difficult at best to evaluate their claims.

330. The Applicants also state that in excess of \$1.45 billion of investment is necessary to achieve these savings.<sup>631</sup> The Applicants provide no further breakout detailing the nature, extent and impact of these investments, however, and they provide little information as to when these investments will be made and completed.<sup>632</sup>

331. Finally, the Applicants argue that these efficiencies will generate extra cash flows that then will be used to benefit the public interest. They maintain that realizing the claimed efficiencies will enable them to become a more effective competitor, enhance and expand services to existing customers, and help support the financial requirements for the new company's in-region, out-of-region, and global plans.<sup>633</sup> We do not disagree that increased cash could be used to accomplish these aims. But, as we reject the majority of claimed cost savings on the grounds that they are either not merger-specific or not easily verifiable, we also reject the attendant benefits as not being merger-specific.

332. We conclude, therefore, that while some portion of the cost savings do satisfy the established criteria, they do not contribute sufficiently to amend our overall conclusion that this merger is not in the public interest, absent the possibility of appropriate, substantial conditions.

## 2. Revenue Enhancements

333. The Applicants estimate additional revenues of \$778 million on an annual basis by the third year after merger closing.<sup>634</sup> They claim that these are efficiency gains stemming from the adoption of best practices by both companies. For example, the Applicants contend that SBC's strength in research and development, along with its expertise in developing and marketing attractive service packages, will enable Ameritech to achieve significant new revenue opportunities in selling vertical services.<sup>635</sup> Similarly, the Applicants claim that Ameritech's strength in selling Centrex services will enable SBC to increase penetration and sales of Centrex in its own territory.<sup>636</sup>

334. The Applicants estimate annual revenue growth of \$778 million from the implementation of best practices between the companies.<sup>637</sup> Specifically, the Applicants expect

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<sup>631</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 17.

<sup>632</sup> *Id.* Kaplan states that "[n]et savings, i.e. savings after investment, begin the second year after closing." He also maintains that these investments must be made before the full savings can be realized. It is unclear, therefore, when these investments must be completed to achieve "full" savings on schedule.

<sup>633</sup> SBC/Ameritech July 24 Application at 38, Kaplan Aff. at para. 32.

<sup>634</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 7, Schmalensee and Taylor Aff. at para. 12.

<sup>635</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 8.

<sup>636</sup> *Id.* at para. 14.

<sup>637</sup> SBC/Ameritech July 24 Application at 38, Schmalensee and Taylor Aff. at para. 12, Kaplan Aff. at para. 7.

increased sales of vertical features (\$230 million), additional lines (\$134 million), directory publishing (\$98 million), data services (\$65 million), wireless services (\$50 million), and all other products and services that the companies offer, such as Centrex (\$120 million).<sup>638</sup>

335. In general, the Commission has not recognized claimed revenue synergies as merger-specific because additional revenues can also be generated through increases in price or increases in quantity. As the Applicants assure us that their projections assume no price increases, the thrust of our inquiry will focus on increases in output which will be generated, according to the Applicants, by the adoption of best practices by both companies. The Applicants claim that the result of these efforts will be an incremental \$778 million in revenue on an annual basis.

336. First, we find that the Applicants fail to account for any increases in input costs due to the corresponding increases in output. For example, the claimed increases in vertical features penetration results from the transfer of best practices from SBC to Ameritech.<sup>639</sup> This transfer comes at a cost, whether it involves retraining Ameritech's sales force or recrafting vertical features packages, or by some other change. As the Justice Department's *Merger Guidelines* state, cognizable efficiencies are assessed "net of costs produced by the merger or incurred in achieving those efficiencies."<sup>640</sup> The net contribution to the merged company from the claimed revenue synergies, therefore, would be something substantially less than the \$778 million claimed by the Applicants.

337. Second, although the Applicants have quantified the projected incremental revenue associated with transfers of best practices between the companies, they fail to provide supporting calculations demonstrating how they arrived at those quantifications. The Applicants point to SBC's merger with Pacific Telesis as evidence of prior experience in these matters.<sup>641</sup> Although we recognize that SBC may have gained valuable experience in this regard, we do not accept such experience as a sufficient substitute for providing the supporting calculations. Additionally, even the Applicants admit that regardless of past experience, "no one can predict with 100 percent certainty when or if all the estimated synergy benefits will occur."<sup>642</sup>

338. Third, best practices, even if fully implemented, can be difficult to verify. We conclude, therefore, that these claimed revenue synergies are speculative at best, are difficult to verify, and lack the supporting evidence to persuade us as to their likelihood and verifiability. In any event, neither party needs to merge with the other in order to learn about selling vertical

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<sup>638</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at paras. 7-9.

<sup>639</sup> It should also be noted that while SBC may enjoy higher penetration levels of vertical services than Ameritech, that Ameritech's percentage growth in vertical services penetration and revenue has outpaced SBC's growth on average over the past five quarters. Average growth in vertical service for Ameritech over 5 quarters is 20.0% vs. 18.4% for SBC. See Daniel Reingold and Ehud Gelblum, *Telecom Services – Local*, Merrill Lynch, (Apr. 16, 1999), at 3.

<sup>640</sup> 1992 *Horizontal Merger Guidelines* at 30.

<sup>641</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 15, Gilbert and Harris Aff. at para. 56.

<sup>642</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at 15.

services or Centrex services. Surely simply hiring experienced personnel or forming a limited joint venture should be sufficient.

### 3. Long Distance

339. The Applicants expect a net benefit of \$300 million from additional revenues and reduced costs in the combined company's long distance operations after it receives in-region, interLATA authority.<sup>643</sup> They cite three main factors, including: 1) increased intra-region traffic over their own networks which reduces unit costs; 2) larger wholesale purchase discounts from increased long distance traffic; and 3) increased long distance revenues from the combination of large business customer bases and implementation of the National-Local Strategy.<sup>644</sup>

340. We recognized in the *Bell Atlantic-NYNEX Merger Order* that savings in the costs to provide long distance services counted as efficiencies.<sup>645</sup> However, any increases in intra-regional traffic and increased long-distance revenue claimed by the Applicants could simply be the result of shifting traffic from competitors' networks to their own. This is not a reduction in the cost of providing services and therefore does not constitute a merger specific efficiency. With respect to being able to obtain larger wholesale discounts, the Applicants have not shown that such discounts (if they can be verified) could not be achieved by alternate less harmful means.

### C. Other Product Markets

341. The National-Local Strategy's emphasis on jump-starting local exchange competition around the country remains the Applicants' primary claimed public interest benefit of the proposed merger.<sup>646</sup> The Applicants, however, also maintain that the merger itself will generate synergies and pro-competitive benefits that will benefit ancillary product markets, including markets for Internet services, wireless services, long distance and international services, global seamless services for large business customers, video services and alarm monitoring services.<sup>647</sup>

342. With respect to wireless services, the Applicants state that the merger expands their geographic reach, thereby enabling them to offer a more seamless and broader footprint to customers. Additionally, the Applicants submit that, as a merged entity, they can offer customers consistency of advanced features, which is dependent on an integrated, regional network to reduce unit costs and maximize efficiencies.<sup>648</sup>

<sup>643</sup> SBC/Ameritech July 24 Application at 38, Kaplan Aff. at para. 26.

<sup>644</sup> SBC/Ameritech July 24 Application, Kaplan Aff. at para. 26.

<sup>645</sup> *Bell Atlantic/Nynex Order*, 12 FCC Rcd at 20067, para. 170.

<sup>646</sup> SBC/Ameritech July 24 Application at 21.

<sup>647</sup> *Id.* at 92-102.

<sup>648</sup> *Id.* at 94.

343. The Applicants also maintain that the merger will stimulate greater competition in the national market for Internet services.<sup>649</sup> According to the Applicants, today they hold less than 2% of this national market on a combined basis.<sup>650</sup> Although they currently provide only dial-up access services, both SBC and Ameritech are deploying high-speed data networks and services. Moreover, SBC has an equity stake in Williams Communications, which owns one of the largest nationwide fiber networks. The Applicants conclude that the only effect of the merger in this market will be to help them to compete better against more dominant competitors.<sup>651</sup>

344. The Applicants contend that the merger will help reduce concentration and promote competition in the long distance and international services market. The Applicants use the following logic to support their contention: the merger makes possible the Applicants' pursuit of the National-Local Strategy; the National-Local Strategy, in turn, calls for offering a full bundle of data and voice services, including long distance and international services.<sup>652</sup> The full competitive benefit in the long distance and international services market, therefore, is dependent on the merger. By capturing a share of out-of-region long distance traffic, coupled with in-region traffic once section 271 authorizations are secured, the Applicants believe they can add to competitive choices in these markets that they claim is still dominated by AT&T, MCI WorldCom and Sprint.<sup>653</sup> They believe that internationally, U.S.-based business customers should benefit from the Applicants' expanded geographic reach into 14 major foreign markets by paying lower international termination rates and other such costs.<sup>654</sup> Applicants also maintain that as they follow their large customers out-of-region domestically, the realities of the marketplace will also require that they follow them to foreign markets.<sup>655</sup> We have discussed the international component of the National-Local strategy above.

345. Finally, the Applicants claim that as they expand out-of-region and begin to provide bundled services, the long distance providers and competitive LECs will have to compete to preserve their existing long distance and full-service customers.<sup>656</sup> As the Applicants themselves have noted, they are currently able to provide long distance service out-of-region immediately,<sup>657</sup> though they have refrained from doing so. Further, as the Commission found in the Bell Atlantic/NYNEX merger order, the experience of other incumbent LECs in offering in-region interexchange service suggest that the Applicants can be quite effective competitors once they receive section 271 authority.<sup>658</sup> We, therefore, do not find their argument that the merger will generate more long distance competition persuasive.

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<sup>649</sup>

*Id.*

<sup>650</sup>

*Id.* at 96.

<sup>651</sup>

*Id.*

<sup>652</sup>

*Id.* at 97.

<sup>653</sup>

*Id.* at 96-97.

<sup>654</sup>

*Id.* at 98.

<sup>655</sup>

SBC/Ameritech July 24 Application, Kahan Aff. at para. 67

<sup>656</sup>

*Id.* at para. 90

<sup>657</sup>

*Id.*

<sup>658</sup>

*Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20067-68, para. 172.

346. In the global seamless services market for large business customers, the Applicants claim that the merger will create a strong new competitor with the reach, resources and scale to bring new competition to a market populated by only a handful of major competitors worldwide. This merger will benefit large business customers that not only have domestic telecommunications needs, but transnational requirements as well. According to the Applicants, their increased ability to compete globally through this transaction will spur competition not only in the large business market, but also in the small business and residential markets.<sup>659</sup>

347. We conclude that the merger brings few tangible merger-specific benefits to these other product markets. In general, we find that the only merger-specific benefits to these markets are those related to speed of expansion and reductions in unit costs, such as with consistency of advanced features in the wireless services market. Other than these benefits, we find that each company could expand geographically or offer the products on its own. Specifically, each company individually could expand its respective wireless footprints through other acquisitions or joint ventures that do not threaten equivalent public interest harms. Each company could offer out-of-region Internet services today, so expanding its customer base of dial-up customers could be achieved absent this merger. Each company could offer long distance services out-of-region and abroad today absent the merger. In-region, each company's ability to offer long distance services is subject to section 271 authorizations which are not dependent on this merger. Each company could secure large business customers today in the global seamless services market by leveraging its substantial international holdings and by introducing a full suite of local and long distance voice and data products. These activities, therefore, are not dependent on the merger and could be accomplished individually.

## VII. CONDITIONS

348. We conclude above that the proposed merger of SBC and Ameritech poses significant potential public interest harms by: (a) removing one of the most significant potential participants in local telecommunications mass markets both within and outside of each company's region; (b) eliminating an independent source for effective, minimally-intrusive comparative practices analyses among the few remaining major incumbent LECs as the Commission implements and enforces the 1996 Act's market-opening requirements; and (c) increasing the incentive and ability of the merged entity to discriminate against rivals, particularly with respect to advanced services. We also conclude that these concerns are not mitigated by the proposed transaction's potential public interest benefits. Thus, if our analysis ended at this point, we would have to conclude that the Applicants have not demonstrated that the proposed transaction, on balance, will serve the public interest, convenience and necessity.

349. As noted above, on July 1, 1999, the Applicants supplemented their initial Application to include a package of voluntary commitments that they intended would alter the

<sup>659</sup> SBC/Ameritech July 24 Application at 98-100.

public interest balance in their favor.<sup>660</sup> After receiving extensive public comment on their proposed conditions, SBC and Ameritech clarified and modified their commitments on August 27, 1999, and in subsequent filings.<sup>661</sup> We believe that the Applicants' package of conditions, with the modifications by this Commission, alters the public interest balance of the proposed merger by mitigating substantially the potential public interest harms while providing additional public interest benefit. Accordingly, with the full panoply of conditions that we adopt in this Order, and assuming the Applicants' ongoing compliance with these conditions, we find that the Applicants have demonstrated that the proposed transfer of licenses and lines from Ameritech to SBC will serve the public interest, convenience and necessity.

#### A. Open Process

350. As a threshold matter, we affirm that considering conditions in license and line transfer proceedings is an appropriate and, in circumstances such as this merger, a necessary process in our application review. It is seductively simple, yet short-sighted, to believe that our role is limited to voting an application up or down, measuring an application solely against whether it violates a specific provision of the Act or a specific Commission rule. Such a view rests on the assumption that our market-opening rules will work equally well regardless of the number of major incumbent LECs or RBOCs and of who owns them. As we discussed at some length in Section IV of this Order, however, this would be an incorrect view of our rules, and the current realities of the telecommunications industry.

351. Accordingly, following the Applicants' acceptance of the process outlined in the Chairman's April 1st letter, Commission staff discussed with the Applicants a set of voluntary conditions that might both alleviate our public interest concerns and strengthen the merger's public interest benefits. It is, of course, up to the Commission – not the staff – to judge whether such conditions are sufficient. Throughout these discussions, Commission staff and the parties understood that, although productive dialogue required separate meetings among staff and various parties, this agency is a public agency and it conducts its business in public. Accordingly, our staff followed procedures that were designed to permit effective negotiations in the context of an open reporting process. To these ends, the staff first met with representatives of SBC and Ameritech, with each meeting memorialized by a letter included in the public file of

<sup>660</sup> Letter from Paul K. Mancini, SBC Communications Inc., and Richard Hetke, Ameritech Corporation, to Magalie Roman Salas, FCC Secretary, CC Docket No. 98-141 (filed July 1, 1999) (SBC/Ameritech July 1 *Ex Parte*). See also "Pleading Cycle Established for Comments on Conditions Proposed by SBC Communications Inc. and Ameritech Corporation for their Pending Application to Transfer Control," CC Docket No. 98-141, Public Notice, DA 99-1305 (rel. July 1, 1999).

<sup>661</sup> Letter from Richard Hetke, Ameritech Corporation and Paul K. Mancini, SBC Communications Inc., to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-141 (filed Aug. 27, 1999) (SBC/Ameritech August 27 *Ex Parte*); Letter from Richard Hetke, Ameritech Corporation and Paul K. Mancini, SBC Communications Inc., to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-141 (filed Sept. 7, 1999) (SBC/Ameritech Sept. 7 *Ex Parte*); Letter from Richard Hetke, Ameritech Corporation and Paul K. Mancini, SBC Communications Inc., to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-141 (filed Sept. 17, 1999) (SBC/Ameritech Sept. 17 *Ex Parte*); Letter from Marian Dyer, SBC Telecommunications, Inc., to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-141 (filed Sept. 29, 1999) (SBC/Ameritech Sept. 29 *Ex Parte*).